RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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March 21, 1984 **LETTER 883**

March 9 DJIA 1139.76; PTI 1697; A-D Ratio -18.70
March 16 DJIA 1184.36; PTI 1716; A-D Ratio -17.89

THE MARKET: Is it a bull market or a bear market? In my opinion (although I have removed the bull from the box) the verdict is still out. From the bulls' standpoint, they can point to the fact that the Fed has not yet raised the discount rate. Yet the great majority of bear markets have started *following* boosts in the discount rate. Second, the Dow is selling well below its replacement value of roughly 1800. Most bear markets start with the Dow selling well above replacement value. Third, the so-called lagging indicators may not have even touched their low yet, but almost all bull markets terminate with the lagging indicators rising and usually rising strongly.

From the standpoint of Dow's Theory the issue is not entirely clear. On January 8 both the D-J Industrials and Transports shattered their August 1983 lows. The August lows were rather shallow to be considered true secondary lows, and that is where a Dow Theory question lies. But in breaking the August lows the Averages also smashed a nine month trading range, and in my opinion this lends weight to the bear argument. Overall, my guess is that the primary trend of the stock market is down. The insistence by so many advisors that "this is just a bull market correction" lends weight (I feel) to the bearish designation for this market.

From the bears' side, a number of the moving averages are now giving negative readings. For instance, my 13-week exponential moving average of the Primary Trend Index (PTI) has dropped below the 21-week MA. When this happens the implication is that the PTI has more to go on the downside. But a pull-back (now occurring) is the initial expectation.

Trade Levels (21241 Ventura Blvd., Woodland Hills, CA 91364) publishes what they term "the real NYSE market." This is a daily unweighted average of ALL NYSE common stocks. The 39-day MA of this average has just plunged below the 39-week MA. The 13-week MA of this Average has not been below the 39-week MA since August 1982. So this is another bearish sign.

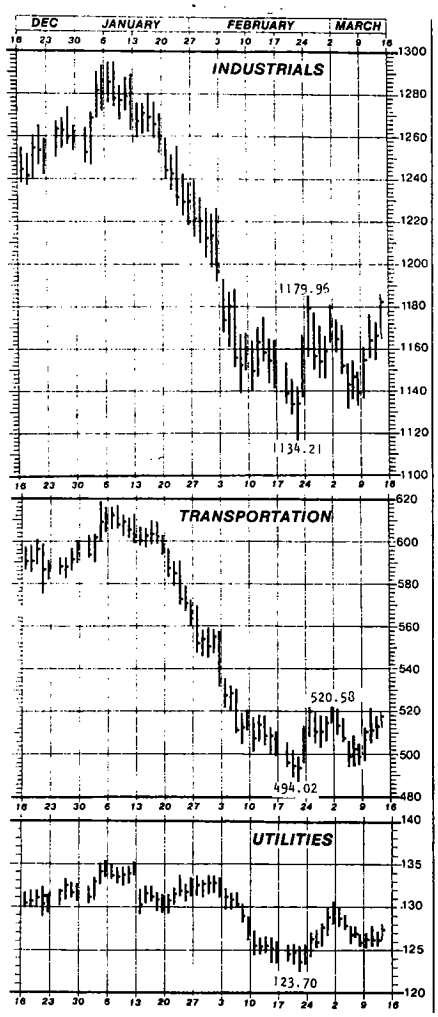
My 13-week exponential MA of the Dow is still 6 points above its 50-week MA. But the 13-week MA is declining and in a few weeks or so (barring a terrific Dow advance) the moving averages of the Dow will be in the bearish mode.

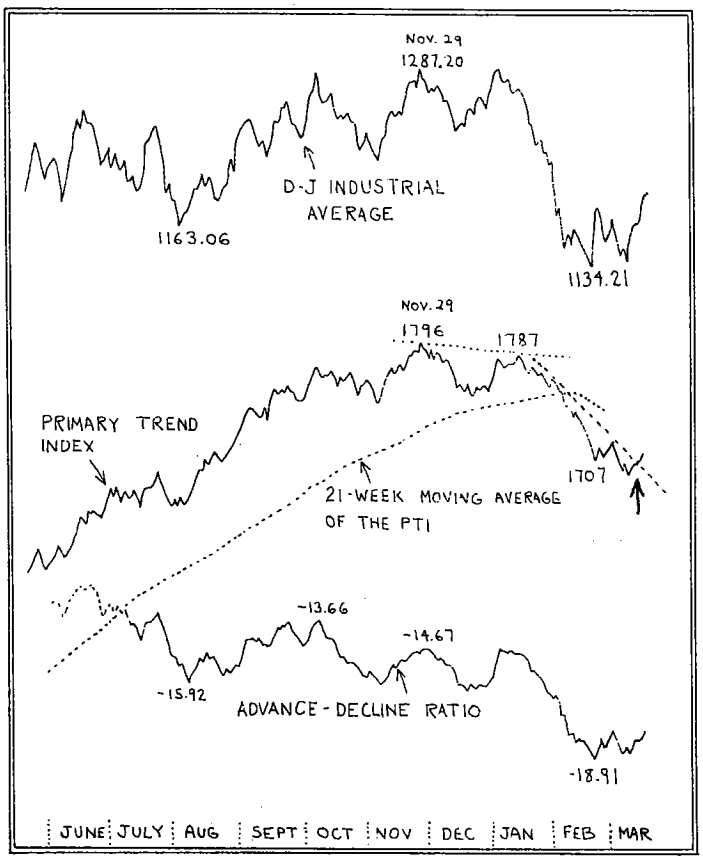
How over-sold was Wall Street at the late-February lows? By February 23 the market had declined on an incredible 27 out of 33 trading sessions. Anytime the market (i.e., the A-D line) drops 82% of the time during a 33-day span, we can assume that the market is very over-sold. And that was the case on February 23.

The lows for 1984 (page 1 chart) were recorded by the D-J Averages as follows: Industrials at 1134.21 on February 22, Transports at 494.02 on February 23. A sharp rally then carried Industrials to a high of 1179.96 (February 27), Transports to 520.58 (March 2). The implications from here are simple enough. A joint breaking of the February 22-23 lows will be a forecast of lower prices and most likely a new leg on the downside. But a bettering of the February 27-March 2 highs would further extend the rally.

Turning to the daily chart (page 2) of the PTI, note that the low was recorded on March 9 at 1607. Since then, the PTI has been edging up, and its first upside target is the March 2 peak of 1723. On March 14 the PTI reversed a steep declining trendline and the PTI is currently 25 points below its 21-week moving average.

The A-D ratio at the bottom of the chart has shown a little better action than the PTI. The February 23 low of minus 18.91 is the level to watch here. It is interesting to note that the A-D ratio is in an eight-month decline, a decline that began on June 16, 1983. But it was only when the PTI turned down in mid-





Janury that the market seemed to "fall apart." The trend of the 21-week moving average of the PTI will tell the story from here on (particularly as far as longer-term trends of stocks are concerned).

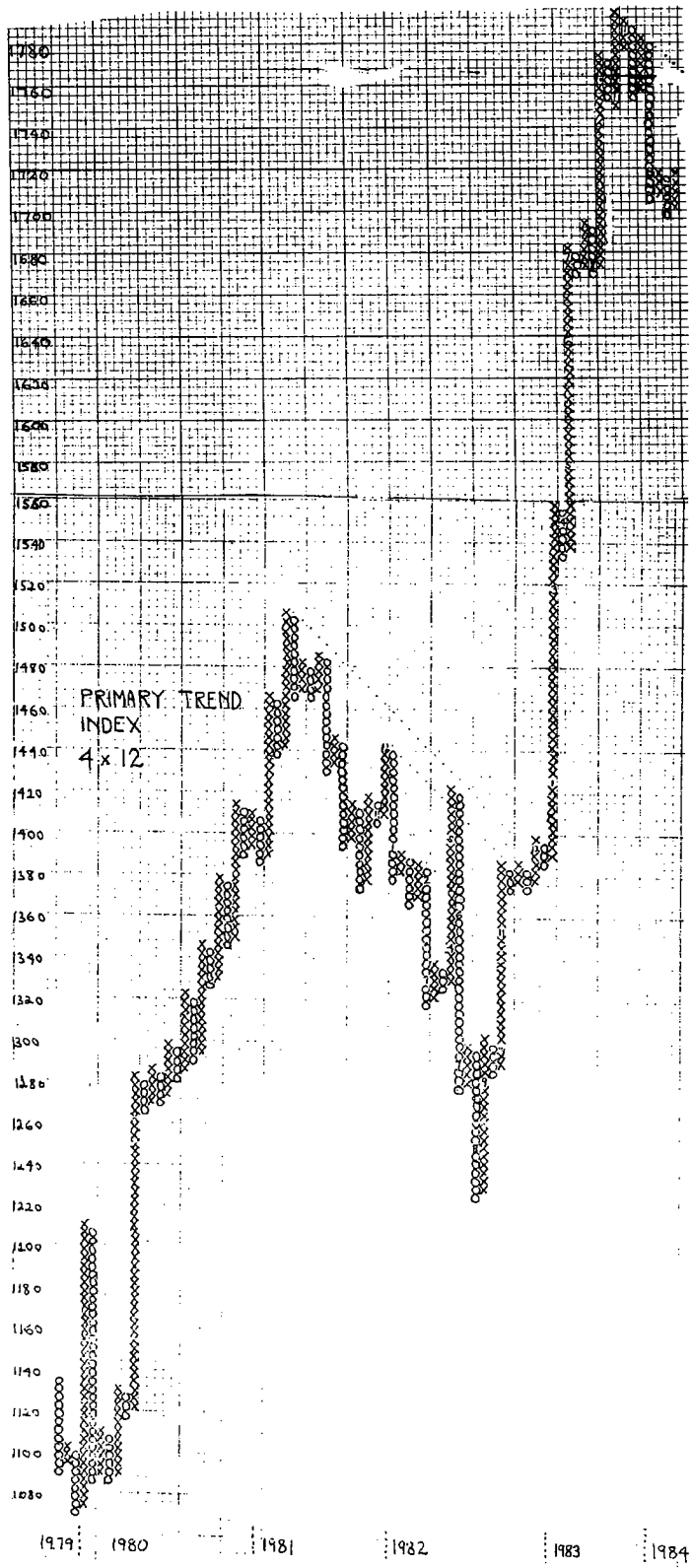
Because I feel that the trend of the PTI is so important here, I have included my point & figure chart of this indicator. As you can see here, the PTI top is well-defined. Following the downside break, a little consolidation formed in the 1708-1720 area. This consolidation formation broke down, and the PTI dropped below 1700. Note that a little bottom pattern has now formed, and the PTI looks like it could move higher.

* * *

A few Letters ago I discussed the importance of the 50% Principle in classifying the market's major trend. Since the halfway (50%) level of the 1982-83 advance comes in at 1032.06 for the Dow, I continue to watch this level with great interest. *So far,* the decline has remained roughly 100 points above the 50% level of the 1982-83 advance, and this is hopeful. But underscore that phrase "so far."

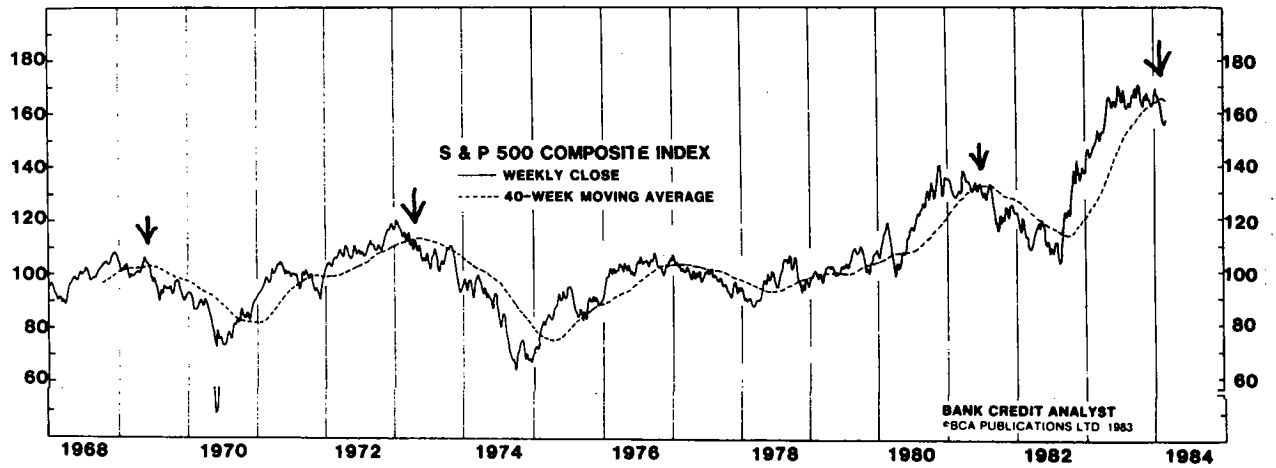
Under the 50% Principle, if the Dow can retain half or more of its previous MAJOR advance, it is a positive sign. It means that the basic under-structure of the market has held together. But if the Dow breaks below the 50% level, the back of the entire rise must be considered broken. If that happens, it would not surprise me to see the Dow sink well below 1000.

CASE HISTORIES: This chart from the *Bank Credit Analyst* is worth studying. It goes a long way towards explaining why I turned bearish when the market took its dive during January and February (aside from the fact that my PTI turned bearish).



The chart traces the broad Standard & Poor's 500 Stock Index from 1968 to the present. Note that four times since 1968 the S & P 500 rose to significant new record highs. In each instance, following those record highs, when the 500 broke below its 40-week (200-day) moving average the subsequent downturn was substantial.

The 1984 plunge below the moving average was the most violent and forceful of any since 1964. Based on past history, we might now expect a pullback to the 40-week MA, but following that the market should be on its way down. How far down? If the S & P



500 matches its shallowest decline since 1968, we could still expect a move down to the 130 area (chart at top of page 3).

INVESTMENT POSITION: Because I am not certain about the direction of the primary trend, I have shown neither a bull nor a bear in this box. However, operating on the thesis that the PTI will keep us on the right side of every MAJOR market move, we will be substantially out of this market (from the standpoint of stocks) until such time as (1) the PTI forms a definite bullish pattern, or (2) the PTI climbs above its 21-week moving average. Since the PTI (see page 2 chart) has now reversed its current steep declining trendline, trading purchases might be warranted here. But as subscribers know, my experience with trading is that 80% of non-professionals tend to end up with losses. For that reason I would prefer to act on longer-term implications.

DISCUSSION: *Question:* Russell, you've been writing about the 42 million investors and the use of computers and the information explosion and instant communication. What effect will all this have on the market?

Answer: My belief is that all the above will cause the stock market (and the other markets) to become more difficult, more volatile and harder to deal with. It's simple. If you're a good card player and you play poker with another good card player, your odds for winning are not too far from 50/50. But if you enter a contest with 500 good poker players your odds on winning go way down, and I don't care how good you are. It simply means that you've got 500 good to very good brains pitted against yours–rather than one.

That, I feel, is what's happening in the market. For instance, ten years ago there were roughly around 1,000 professional money managers. Now the figure is over 7,000. Think of it, 7,000 professionals handling hundreds of billions of dollars worth of stocks and bonds. And these guys have access to all kinds of the best information. It's got to make it *harder* to make money in the markets.

To top it off, I just received a promo sheet about the new *Investor's Daily* newspaper, a paper that should be coming out soon. This paper will provide the public with even more technical and fundamental information. It will publish charts on everything from stock groups to foreign markets to gold indices to a daily new-issue index. The general public will have a whole new source of sophisticated information. And the emphasis on performance will be fiercer than ever.

Question: What do you think the net result of all this will be?

Answer: As I said, increased speculation, increased buying of options, increased pressure to *perform*–and probably more money lost than ever before.

Question: Russell, how do you personally intend to operate in this new atmosphere of "super performance or else"?

Answer: Personally, I feel that I will place increased emphasis on the primary trend of the markets and less and less emphasis on trading and trying to catch even the secondary moves. I will also put increased emphasis on total return, and I will emphasize the fortune-making properties of compound interest.

Question: All right, so you would emphasize the main or primary direction of the market. Can you do this with confidence at a time like this? What is your analysis right now?

Answer: No system is perfect. And the best systems (from what I've observed in over thirty years of watching markets) are never precise, never exact. In other words, all systems demand some degree of interpretation. I've never seen a mechanical system that worked even 85% of the time. Most mechanical systems (no matter how good they are) will occasionally produce costly whipsaws.

Currently, I use five major checks on the status of the stock market. I'll review these five at this time.

(1) I use the Dow Theory, which I have explained and discussed in these reports for years. Right now, my interpretation is that in breaking the late 1983 lows, the secondary trend of the market is bearish. If the February lows are broken (assuming we can extend this rally a bit further), the primary trend will also be down.

(2) I have followed Lowry's "Buying power and selling pressure" service for decades. This service measures the actual buying and selling pressure in the market. Right now, selling pressure is above buying power, but Lowry's has registered a tentative oversold mode. I label the Lowry study bearish until proved otherwise (Lowry's, 350 Royal Palm Beach Way, Palm Beach, FL 33480).

(3) I follow the "Very long-term probability index" (a mathematical formula) developed by Trendex. This formula gave a sell signal in February. These Trendex sell signals (since 1949) have averaged 18 months, but the subsequent buy signals tend to

be late. Nevertheless, this formula is now on a sell mode (Trendex, PO Box 1978, San Antonio, TX 78297).

(4) I follow the *Bank Credit Analyst's* appraisal of the markets with particular attention to their debt/loan ratio. This ratio relates money payments to short-term indebtedness, and as such it treats the whole US economy as if it were a huge single corporation. Right now the Debit/loan ratio is heading down, and this means that corporate profits will be under pressure in the period ahead. Noting that stocks are now extremely over-valued compared with bonds, the Bank Credit Analyst is quite negative on the stock market. (Bank Credit Analyst, 3463 Peel Street, Montreal, Quebec, Canada H3A 1W7).

(5) Finally, or last but not least, I use my Primary Trend Index as an instrument that will keep me on the right side of the market. Although the PTI can produce whip-saws and late action in both its buy and sell signals, it is almost guaranteed to keep my subscribers and me on the right side of MAJOR moves. The PTI is now negative. On a strictly mechanical interpretation, the PTI is bearish because it is traveling BELOW its declining 21-week moving average.

So the background for all five of these broad indicators is now negative. If the market were suddenly to change or turn decisively up, the first two indicators to confirm such a move would probably be the Lowry study and my PTI. But so far, as I say, I get a uniformly negative reading on all.

Question: Russell, what do you think has "gone wrong" with the stock market? Why is the market so sick here?

Answer: I can answer this two ways. The first is purely technical. If you go back a few months you will note that I wrote extensively about the year-to-date momentum index for the S & P 500 Index. I noted that in July 1983 this index rose to the 52% level, which means that the S & P 500 Index was 50% above its price of one year earlier. Now this has occurred only twice before in modern history, in 1933 and again in 1943. Each of those upside explosions was followed by a long period of consolidation and correction lasting 11 months. I said at the time that if history were to repeat, the current market might not turn up again until around June 1984.

The 1933 momentum explosion was followed by a 20% drop in the Dow. If history repeats, the Dow could end this decline near 1000. The 1943 momentum explosion was followed by a 10% decline. If we repeat the 1943 situation, then 1150 on the Dow (which is where we are now) would about do it.

That's the happy side of the equation. In other words, it is possible that the stock market is simply working off the effects of an upside explosion just as it did during 1933-34 and 1943-44.

Question: All right, what's the other side of the picture?

Answer: The other side of the picture has to do with *values.* Right now the yield spread in favor of bonds over stocks is roughly at its highest point in history. This situation presents professional money managers and large, sophisticated investors with a tremendous problem. The problem is this: it's near-impossible at this point to justify the purchase of stocks over bonds.

Let me give you a real example. Last week I bought twenty year Treasury bonds for my pension plan. At the price I paid (and I purchased an odd-lot) the bonds will yield 12.40%. In five years at that rate, $100,000 grows in a tax-deferred pension plan to $177,000. To match that the D-J Industrial Average would have to rise to 2070. In ten years at 12.43% my $100,000 will grow to $316,000. To match that the Dow would have to rise to 3634.

Now don't get me wrong. I'm not saying that Dow won't be 2070 in 1989. And I'm not saying the Dow can't go to 3634 by 1994. But can you guarantee it? As far as my bonds are concerned, they are guaranteed to grow to $177,000 in 1989 and $316,000 in 1994—unless the US Treasury goes belly up or a moratorium is declared on US debt. And if either of those contingencies arrive, chances are the Dow will be flat on its back anyway.

So that is the tremendous problem facing big money today! Furthermore, as time goes by my feeling is that more and more money managers and large investors will see that 12.40% annually and guaranteed is more than they can expect in the stock market. Over any reasonable length of time, I believe the average fund manager or pension fund manager will have a very hard time outperforming at a 12% return. Some managers may outdo that figure—but not many.

Question: What if rates come down? If that occurs stocks will look like the place to be, and bonds will be less attractive.

Answer: With the Federal debts rising at an average rate of around 10% or more and with deficits of $150 to $200 billion, it's hard to see rates coming down substantially. Nothing I see tells me that the Congress or the nation is willing to go through the pain of bringing rates down (that pain would entail cutting the Federal budget to shreds while raising taxes).

But let's assume that rates do come down. At that point the bonds take off to higher levels and the bond holder is still in the driver's seat. On the other hand, if money rates go higher the investor simply continues to buy bonds at the new higher rate. Consider this: at 12% you get one-third of your capital back in three years. In order to lose on a total return basis, the bonds would have to drop one-third from today's level. If that happens, interest rates on new Treasury bonds would be around 18%. And at 18% for long-term money, this nation would be in a depression. And given a depression, one would still be better off in Government bonds than in stocks.

Question: Russell, are you saying that the big move in stocks is over? Are you saying that the yield spread between stocks and bonds has sealed the bull market's doom?

Answer: I can only work with what I see. If, and I say if, Congress does what it has to—to lower the Federal budget deficit, then the markets have a chance. But we've passed the place where bandages and compromises and words will cure this country. A tax rise of $30 or $40 billion won't do the trick, neither will a budget cut of the same amount. The deficits are simply running up too fast. The cost of carrying the Federal debt is going to climb over the $150 billion mark next year. We're being eaten alive by our debts; we're being compounded to death.

I don't know the answer here, but I do know mathematics. And mathematics are telling me that the odds lay with bonds rather than stocks in this area. Why? Because it's a question of (1) will there be a US Treasury in 1990? If there is then my money will double by then. (2) Will the Dow be at 2300 by 1990? Maybe, but my knowledge of risk/reward tells me to go for proposition No. 1 before I go for proposition No. 2.

Question: Russell, you pushed for a national 5% sales tax, the proceeds of which were to go entirely towards reducing the deficit. What was the result?

Answer: The plan was presented to a top White House advisor. So far the result has been–nothing. Mr. Reagan obviously wants to put the economy "on hold" until after the election. Whether that policy will work, I don't know.

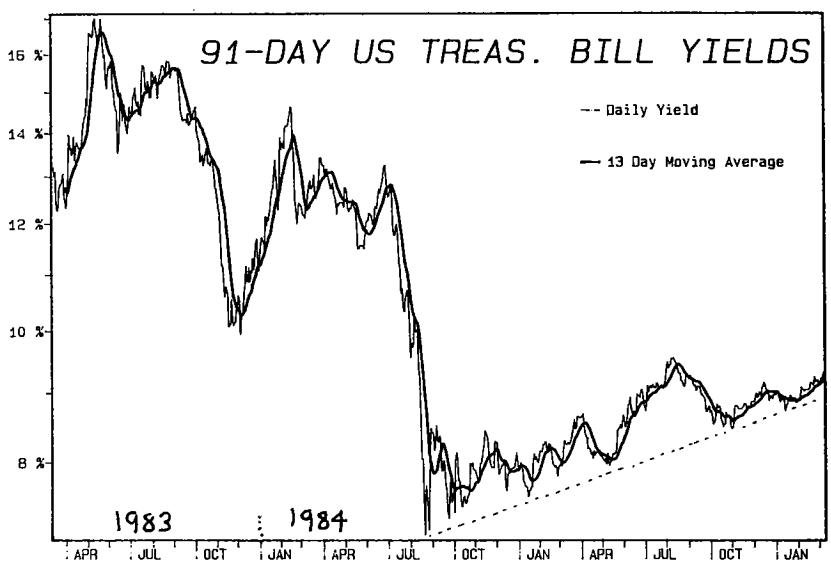
Question: Don't you think you should advocate cutting expenses rather than opting for a 5% sales tax?

Answer: The Federal debt has jumped almost 50% in the last few years–to above $1.4 trillion today (I remember telling subscribers that it was approaching $1 trillion, and that was not too long ago). Congress is not going to do what is necessary on the reduction of spending end. And the deficit keeps growing. So I say, "Move, pay for what we spend." I say eliminate the deficit via the sales tax. That's something that can be done quickly. Then if Congress wants to cut spending, cut the sales tax proportionately. But in the mean time the job gets done; the deficit is reduced or eliminated.

Question: If you could, would you eliminate the present tax system?

Answer: You bet I would, and without a second thought! The whole tax thing is becoming a racket. It's the biggest industry in this nation except for corruption. When you think of the time, the money, the manpower that is wasted on the tax avoidance game: the tax reduction game, the tax shelter industry, the cost of the vast army of tax accountants, and then you consider the other side: the IRS, the thousands of agents, the time spent in Congress on generating new tax bills, why the whole thing has become INSANE. We've built one of the biggest vested interest INDUSTRIES in the nation–the tax and tax avoidance industry. I'd hate to think of the millions of man hours that go down the drain each year in the tax industry. And all of it really non-productive wasted man hours.

If I had my way I would institute a flat tax for the nation and eliminate the whole ridiculous tax industry. The savings in money, time and energy could literally revitalize this nation!



INTEREST RATES: Nobody in his right mind expects interest rates to come down. But this chart (thanks to subscriber John Carder of Colorado) is interesting. Here we see the bellwether T-bills climbing slowly higher in yield, following their precipitous yield drop of 1983. I've often seen extended SHALLOW rises like this one reverse–and reverse very suddenly. It would take a dive to about 8.7% yield for the T-bills to reverse and forecast lower interest rates. That may not happen, but what does interest me is the very shallowness of the current rise.

NOTES & QUOTES: It has been estimated that over $60 billion has gone into oil company takeovers in the US in the last few years. In other words, it's cheaper to buy the oil companies than it is to find the oil. So that's $60 billion that will not go into oil exploration, and the vast portion of that money has been borrowed.

All of this helps OPEC. It helps OPEC because US money simply changed hands instead of going towards developing new US oil sources. Thus the US continues to stay dependent on OPEC oil. And so it goes.

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The Market Technicians' Association is holding its 9thAnnual Seminar in beautiful Monterey, California on May 9-12. I'll be one of the guest speakers at the meeting. It should be a most interesting get-together and a most worthwhile affair. The seminar is open to the public. For more information call Toni Bessela at (609) 452-7314.

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The Gary Hart phenomenon is a most fascinating one. In my opinion, the most fascinating part of it is that Hart neither represents big labor nor big business. In fact, the AFL/CIO endorsed Mondale strongly, and Hart's popularity must set big labor to thinking about what the devil has gone wrong in this country. I thought the WSJ's editorial of March 8 was excellent, and here's a piece of it:

> The rise of Gary Hart and all this talk about his "new ideas" is indeed fascinating, but we think it has to be viewed in the context of Mr. Mondale's failure. It's important to keep in mind that a primary is not quite an election. It is an opportunity for members of a party to choose whoever they think has the best shot at beating the opposition candidate. The opposition in this instance is the president of the United States, and there may be some doubts that Mr. Mondale's extremely traditional Democratic politics have much chance of beating Mr. Reagan. Everyone thinks that the '57 Chevy, like Hubert Humphrey, was a classic model, but GM doesn't think it can still beat the competition selling those things.

Scandals continue to rock San Diego. Fresh on the footsteps of the J. David securities scandal (in which $125 million in investors' money has seemingly disappeared), the curtain descended on the Miss San Diego contest. Our winner, a lovely brunette, was just de-crowned, and the crown then was given to the runner-up. Why? What happened? It seemed that the lovely winner had not disclosed that she had posed in the nude for Penthouse Magazine, a contest "no-no." Local citizens are shaking their heads and wondering, "What next?"

* *

I'll be in NYC next week trying (assuming the temperature is above freezing) to have a good time in the City of Fun. Then it's down to Washington to be grilled by the powers that be on Wall Street Week (March 23). Next, it's back to God's country in San Diego. By the way, San Diego is now the 8th largest (population) city in the country. So I'm not talking this town up any longer. In fact, you can quote me as saying "The food's lousy here. Not a three-star or even a two-star restaurant within 100 miles–and that's a fact."

* *

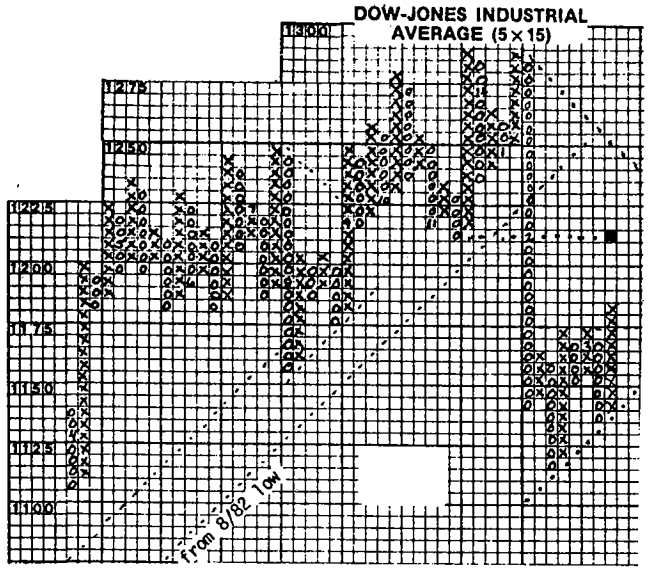
Mistake: In Letter 882, page 5, is written that at 12% interest compounded, $1,000 will grow to $9,646. I was wrong (or maybe too optimistic). $1,000 at 12% will in 10 years grow to $3,105. And in 30 years $1,000 at 12% will grow to $29,959 (both assuming, of course, that taxes are deferred).

* *

According to almost everything we read, the dollar is heading for the basement. Maybe. But Geoffrey Bell, head of a NY investment advisory firm dissents. He notes that (1) Up to recently, the dollar accumulating countries were the OPEC nations. These nations are now running deficits. The new dollar accumulators are Japan and the industrialized nations of Europe. By tradition, their Central Banks hold dollars. (2) After 25 years of growth, the Eurodollar market has stopped growing. This is removing an excess supply of dollars from the market. (3) International investors are now buying monetary assets. This is a change from recent years when they bought inflation hedges such as land, gold, commodities, etc. The high return on the dollar is proving irresistible to these large investors.

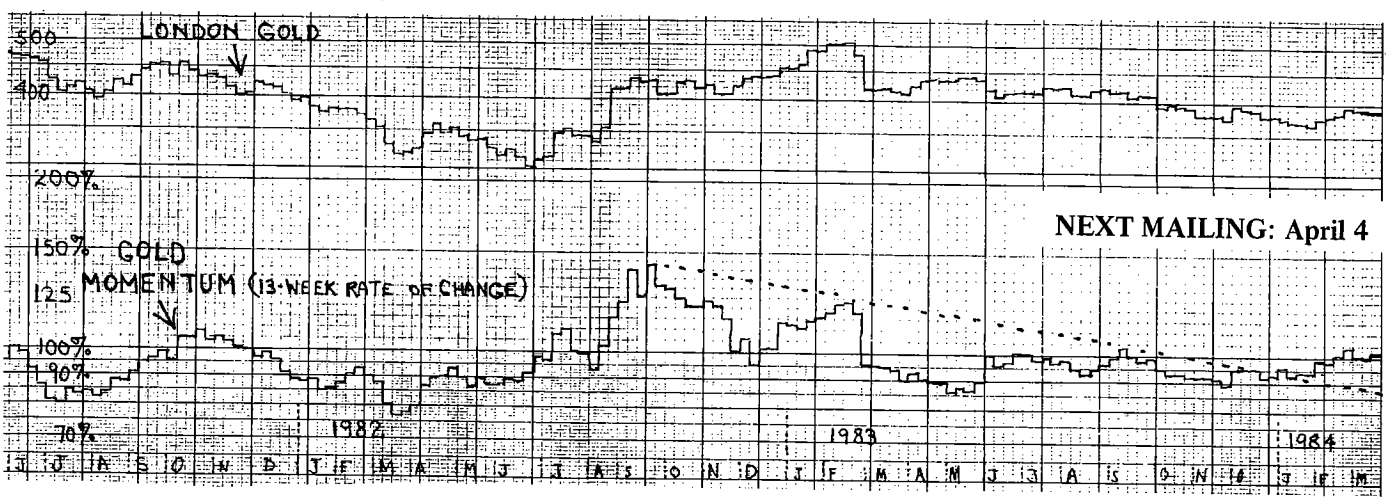
Thus, despite a barrage of bad news on the trade deficit and the budget deficit,there are still some major plusses for the dollar.

LATE NOTES: The market finished the week (ending March 16) with a bang. This P & F chart (courtesy of Chartcraft, Larchmont, NY) shows the bullish formation that has now appeared off the bottom. The Dow should be able to rally to 1215 before it hits major resistance. I have shown the resistant point with a black box at the 1215 level. More and more, I am thinking that stocks are being locked into a "trading range market" with the old highs offering major resistance and the recent lows offering good support (I'll explain this further in the next Letter).



GOLD: In recent Letters I stated that gold would have to touch 408 in order to turn bullish according to my studies. Last week gold got as high as 406.65, and then started selling off. By week's end gold (spot) was below 393. The picture is simple enough. At 408 gold gives an initial point & figure "buy" signal on my chart. At 412 gold reverses its secondary bearish trendline. Neither of these events has occurred at the time of this writing.

I include here my weekly chart of gold and gold momentum. The gold momentum is a 13-week rate-of-change chart. Note that in late-January gold momentum broke above a 17-month declining trendline. Momentum has now risen to above 100. Ordinarily, this should have triggered an impressive gold advance. But so far, the gold price has not confirmed the gold momentum breakout. And as so often happens, when a technical failure occurs the price slips back again. That's where we are now with gold. I'm stubborn–I still want to see gold move to 408 and above, before I turn bullish on the metal.



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